



GOVERNOR'S TRANSACTION PRIVILEGE TAX SIMPLIFICATION TASK FORCE ONLINE RETAIL WORKING GROUP MINUTES

Tuesday, November 13, 2012

9:00 AM

1820 W. Washington, St. #200, Conference Room 101
Phoenix, Arizona 85007

A public meeting of the Transaction Privilege Tax Simplification Task Force was convened on November 13, 2012 in Conference Room 101, 1820 West Washington, St. #200, Phoenix, Arizona 85007. Notice having been duly given. Present and absent were the following members of the Task Force.

Members Present

Michael Hunter (Chair)
Steve Barela
Miguel Teposte
Tom Belshe
John Olsen
Linda Stanfield

Keely Hitt
Vince Perez
Kevin McCarthy
Lynne Herndon
Senator John McComish
Representative Rick Gray

Members Absent

No members were absent.

Staff Present

Lindsay Scornavacco, Governor's Office
Chris McIsaac, Governor's Office

1. Call to Order

Michael Hunter called the meeting to order at 9:02 a.m.

2. Amazon Settlement

Dennis Hoffman, Chair of the Online Retail Working Group, stated there have been a lot of important outcomes since the Working Group's last meeting, including election outcomes and an agreement with a major online retailer.

a) Update from Department of Revenue

Mr. Hunter stated an agreement between Amazon and the Department of Revenue was announced in the newspaper. The details of the agreement are subject to confidentiality laws, but Amazon did announce certain aspects of the deal to explain the differences in their SEC filing this year from last year. That information is public. Mr. Hunter stated he is looking for Vince Perez to describe how Arizona sees its tax situation post settlement and what work is still left to be done.

Vince Perez stated the Arizona confidentiality laws are expressly clear that he may not talk about any one taxpayer directly. The Arizona Department of Revenue's position has been to look at nexus

and any type of physical presence to determine what is taxable. He continued that the Department of Revenue does not stop at nexus, but makes determinations based on complete business models. Two roadblocks that remain are the sourcing language and uniformity on the retail front. Mr. Perez stated federal legislation will be coming down to the states possibly this month and the state needs to put itself in a position to be ready to meet any criteria Congress may pass.

Mr. Hunter commented he understands many people have been focused on this particular taxpayer and this specific settlement, but the effort of this working group is to develop a tax system that can keep up with emerging technology and maintain fair and equitable treatment of taxpayers. That effort is ongoing. He continued there are still a series of recommendations that come from this working group Dr. Hoffman has lead.

b) Working Group Discussion and Public Comment

Dr. Hoffman stated Amazon owns affiliate retailers. He asked if it was reasonable to assume that every transaction that falls under Amazon and its affiliate seller will be subject to tax. Dr. Hoffman commented he fully understands if the Department of Revenue is unable to answer his question.

Mr. Perez stated he is not comfortable answering the question without having the SEC filing with him.

Kevin McCarthy stated it is his understanding that products purchased online located in Arizona are subject to tax. Products purchased online that may come from a warehouse in Alabama would not be subject to tax.

Mr. Perez stated he disagreed with Mr. McCarthy from a tax perspective. Of the top 100 e-tailers, 60% already collect and remit tax to Arizona. All sales are deemed taxable regardless of the product's physical location when nexus has been determined for a company. He stated the Department of Revenue's approach is destination based sourcing. Mr. Perez found Amazon's SEC filing and read a section that says Amazon and wholly owned retailers will collect and remit tax, to answer Dr. Hoffman's question.

Craig McPike from Snell & Wilmer asked if the tax in question is TPT or use tax.

Mr. Perez answered it is TPT.

Michelle Ahlmer from the Arizona Retailers Association stated it is important to understand that although the Amazon agreement is significant it is not the only issue for online retail. She continued the retail community has been very excited about this working group and that moving forward on sourcing and uniformity is important to all retailers, online or otherwise.

Dr. Hoffman commented that even though Amazon is an enormous online retailer, distortions will remain as consumers shift to other online retailers to avoid the tax.

Mr. Perez stated companies that sell more than \$500 worth of product online are required to file with the 1099K program. The IRS sends all of the tax information on those small sellers to the states.

Keely Hitt asked if it would only be information on transactions made with a credit card.

Mr. Perez answered it will be on any third party vendor that reaches the \$500 limit.

Mr. Hunter stated the Department of Revenue can get more information to Ms. Hitt after the meeting.

3. Online Travel Company Issues

a) Presentation: Cindy Ohlenforst, Travelocity

Cindy Ohlenforst representing Travelocity and John M. Allan representing Expedia gave a joint presentation. Ms. Ohlenforst stated Arizona is one of the many states that gets it right in terms of not taxing services. She continued online travel companies act as intermediaries between the traveler and the hotel. This process could be done without the internet, but the internet is obviously easier and faster. She used the analogy of sending a friend to get coffee and allowing the friend to keep the change to describe how online travel companies function. Online travel companies take money and hold the reservation for the traveler. Online travel companies do not control the rooms. Ms. Ohlenforst stated the hotel should only be taxed on the money it receives.

b) Presentation: John M. Allan, Expedia

This agenda item was combined with the previous presentation.

c) Working Group Discussion and Public Comment

Lynne Herndon stated the issue is that online travel companies offer hotel rooms at a lower price. If the hotel rooms online were the same price as offered by a hotel, there would not be an issue.

Ms. Ohlenforst responded the hotels choose to offer this lower price to online travel companies.

Ms. Herndon stated the hotels do this so that travel companies may have more business.

Ms. Ohlenforst replied the online travel companies actually bring hotels more business.

Mr. Allan stated online travel companies negotiate on behalf of the consumer and are not operating on behalf of the hotels. These companies provide a personal service. He continued the state could decide to tax all services, but right now that is not the law.

Mr. Perez asked what stops an online travel company from dividing a \$90 dollar room purchase into a \$30 dollar room charge and a \$60 service charge.

Mr. Allan responded online travel companies must negotiate a price with the hotels and build a contract.

Ms. Ohlenforst commented if the online travel company only gave the hotel \$30, they would not accept it for the room.

Mr. Allan stated most contracts are variable and may change all the time.

Ms. Ohlenforst compared the variable cost of hotel rooms to the variable costs of airfare. Customers

are aware the person sitting next to them on an airplane may have paid more or less than they did for their ticket.

Mr. McCarthy asked if online travel companies are limited to booking hotel rooms or if they offer extras such as ski lift tickets or pink jeep tours.

Ms. Ohlenforst stated if states taxed personal services then whatever online travel companies decided to offer would be taxable. She continued that the conversation is focused on hotel rooms.

Ms. Herndon asked Mr. Allan and Ms. Ohlenforst to describe how online travel companies are different from travel agents.

Mr. Allan stated most states tax either at the state or local level costs paid by hotels to furnish rooms. Commissions paid by hotels to travel agents are included in the hotel tax. Amounts paid by consumers to travel agents are not subject to hotel or sales tax. Hotel expenditures and fees are part of the tax base. The fee paid to online travel companies is paid by the consumer and not the hotel and therefore online travel companies provide a personal service. He continued that this industry should not be singled out for special treatment when all other personal services are not taxed.

Ms. Ohlenforst stated the critical difference is what money the hotel receives. When \$100 is paid to the hotel, tax is due on the \$100 because the hotel has \$100 worth of income. The ten dollar commission paid to the travel agent is already paid with the hotel's money. Following the September 11th attack, the travel industry plummeted and hotels sought to find a way to sell their rooms. Hotels decided to allow online travel companies to book rooms at discounted rates. She continued that if the online travel company books the room for \$80, then the hotel only receives \$80. The consumer may have paid \$20 to the online travel company and \$80 dollars for the room, but the hotel never sees the \$20. The hotel only has \$80 of taxable income.

Ms. Herndon stated there is a service fee being paid by the consumer, but the benefit goes to the hotel because otherwise consumers would not know the rooms are available.

Mr. Allan stated there is a benefit to the hotel, but the hotel does not pay the online travel company.

Ms. Herndon commented if the hotel charged \$100 for a room instead of \$80, then the amount the online travel company charged would be different because the online price needs to look attractive to consumers.

Ms. Ohlenforst responded that this situation is analogous to airlines. If consumers book a flight far in advance, they may pay less. Conversely, if consumers wait to purchase airfare, they may pay more. Whatever is paid to the airline is subject to tax. Whatever is paid to the hotel is subject to tax.

Ms. Herndon stated the issue is that consumers cannot walk into a hotel and see the going rate for rooms in comparison to the online price.

Ms. Ohlenforst stated consumers obviously benefit from online travel companies or they would be out of business.

Mr. Allan commented people book with online travel companies because of the lower prices and services they offer. They find value in the services they provide and pay the online travel companies. The hotels do not pay them.

Mr. McCarthy stated this issue cannot be solved from a policy standpoint within the narrow view of hotel rooms. When taxable events such as golf, lift tickets and pink jeep tours are being booked by an industry with exemption certificates, a completely different set of policy implications should be considered. This effort is to simplify the system and everyone needs to be careful about creating new groups of taxpayers where they do not need to exist.

Mr. Allan stated that online travel companies, as third parties, make business decisions based on the cost of compliance.

Dr. Hoffman asked if there were service areas in Arizona that are taxed.

Mr. Perez stated construction is taxed.

Linda Stanfield stated she is unsure if this model exists in the hotel industry, but in construction companies send consultants to projects all the time and still have to collect taxes. There are overlapping areas. A salon may provide a personal service and additionally sell products. She continued there may be companies that sell rooms on behalf of the hotel.

Ms. Ohlenforst stated online travel companies are completely unrelated to hotels.

Mr. Allan commented he is not aware of any hotel that has the type of agreement described by Ms. Stanfield. The courts have decided to address that issue only if it actually arises.

Dr. Hoffman stated part of the problem is that statute and case law are often decades old and are not equipped to deal with online transactions. He asked Mr. Allan if statute could be crafted narrowly enough to clarify if the business activity of online travel companies is taxable. He also asked if anyone from the cities could comment on this issue.

Mr. Allan answered yes.

Mr. McPike stated there has been an ongoing audit that prohibits the cities from talking about this issue.

Mr. Perez commented there are different tax bases between the state and cities.

Mr. McCarthy asked who the Georgia court case decided remits the tax.

Mr. Allan responded online travel companies were given a choice. Either the online travel company can remit the tax or it can pay the hotel and the hotel can remit it.

Ms. Ohlenforst commented New York and North Carolina are the two states that have decided to tax services.

Senator McComish asked Mr. McCarthy if he could envision language so narrow that it would not create another class of taxpayers.

Mr. McCarthy answered no. He stated he could think of ten corollaries where service is clearly not taxable. He continued that nobody thought taxing construction was a good idea and that everyone would unring that bell if possible. It seems as if this would be ringing another bell.

Senator McComish asked how big of a revenue impact this has on the state and cities.

Mr. Perez stated the state deemed this area not taxable years ago.

Ms. Herndon stated she is not debating what should be taxable. The state does not need a new bucket of taxpayers, but online travel companies should be treated like travel agents.

Mr. McCarthy questioned why hotels shouldn't be taxed on the real value of the hotel room if everyone knows they may sell the room at one third of the price at any given night.

Representative Gray stated this task force was organized to create simplification, not to expand the tax base. He continued that whether the tax base should be expanded is a viable conversation, but it is for a different task force.

Lee Grafstrom from the Unified Audit Committee stated this issue is treated differently under state statute and the Model City Tax Code. The state only taxes revenues hotels receive. Under the Model City Tax Code broker provision, anyone acting on behalf of another should be treated the same. This can be seen with property managers. They collect rent and pay the owner the rent less their fees and other expenses. The amount paid by the tenant is taxable regardless of how much trickles to the owner.

Dr. Hoffman asked if it is simpler to have a broker provision.

Mr. Grafstrom answered yes. The amount the consumer pays is known, but intermediary expenses are not.

Mr. McPike read the definition of broker from the Model City Tax Code. He stated he does not believe the merchant model of the online travel companies falls under that provision.

Ms. Ohlenforst stated if the hotel receives \$80 and the online travel company receives \$20, the hotel has no rights to the \$20. The hotel is not even aware of the amount the consumer pays the online travel company.

Mr. Grafstrom stated the broker and principal are both responsible for the tax.

Mr. Allan responded that the hotel is not the online travel company's principal. Online travel companies are not agents of the hotel. They represent the consumer.

4. Working Group Final Thoughts and Comments

Dr. Hoffman stated the working group has assembled a tremendous amount of information for the

Task Force to use in its recommendations. The working group has also done a lot of background work to prepare for future federal legislation. Dr. Hoffman thanked Mr. Hunter and the Task Force for allowing him to chair the working group.

Mr. Hunter thanked Dr. Hoffman for all of the energy he put into this working group. He stated the Task Force can expect the Chairman's draft of recommendations at the November 27th meeting. At this meeting, Task Force members and working group chairs will be able to provide input. Mr. Hunter stated he appreciates the discussions that toggle between getting into details and then looking at the issue from 30,000 feet. It is from these conversations that good policy emerges. He continued there may need to be an additional meeting to adopt the final recommendations for the Task Force.

5. Adjournment

Mr. Hunter adjourned the meeting at 10:35 a.m.